IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

Income Tax Appeal No.667 of 2005
Date of decision: October 16, 2006

M/s Munjal Sales Corporation, Ludhiana

v.

Commissioner Income Tax, Central Circle-I, Ludhiana and another

Present: Mr. Akshay Bhan, Advocate for the appellant.
Mr. S.K.Garg Narwana, Advocate for the respondents.

CORAM:
Hon'ble Mr.Justice Adarsh Kumar Goel
Hon'ble Mr. Justice Rajesh Bindal

Rajesh Bindal, J.

This appeal by the assessee is directed against order dated 21.6.2005/25.7.2005, passed by the Income-tax Appellate Tribunal, Chandigarh Bench `A' (for short, `the Tribunal') in I.T.A. No. 634/CHANDI/99, for the assessment year 1996-97, raising the following substantial questions of law:

> "(i) Whether in the facts and circumstances of the present case, order vide Annexures A.1 to A.3 are based on mis-appreciation of facts and law involved in the case and liable to be set aside, especially when the provisions of Section 36(1)(iii) of the Income Tax Act, 1961 are not applicable in the instant case ?
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> (ii) Whether in the facts and circumstances of the case, the action of the authorities below in disallowing the interest being 15% of the total amount of interest free loan advanced by the appellant to its sister concern, without consideration of this important fact that the assessee/appellant is earning profits of more than 1 crore and therefore the interest free loan is far below than the amount of profit earned in the relevant assessment year 96-97, is liable to be set aside ?
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> (iii)Whether the action of the authorities below in disallowing the interest free loan so advanced by appellant to its sister concern without specifying as to from which claim of interest paid, the disallowance has been made, is unsustainable and liable to set aside ?
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> (iv) Whether in the facts and circumstances of the present case, the action of the authorities below in disallowing the interest without considering the fact that all the advances so made were old ones and

no advance was made during the assessment year 96-97, is legally sustainable in the eyes of law ?

(v) Whether in the facts and circumstances of the present case, the action of the authorities below in disallowing the interest for the relevant AY 96-97 without any change in the circumstances, when the same was allowed during the previous year i.e. AY 93-94, is legally sustainable in the eyes of law ?

(vi) Whether the action of the authorities below in disallowing the interest in the hands of the firm and simultaneously not allowing any relief in the hands of the partners by reducing the interest taxable in their hands by the same amount, without considering the provisions of Section 28(v) of the Income Tax Act, 1961, so as to avoid double taxation of the same income, is unsustainable in the eyes of law and is liable to be set aside ?

(vii) Whether in the facts and circumstances of the present case, the action of the Ld. Tribunal in allowing the telephone expenses so claimed by the assessee/appellant partly and not fully, is arbitrary and merits reconsideration ?

(viii) Whether the action of the authorities below acting of its own presumption is legally sustainable ?

(ix) Whether in the facts and circumstances of the present case, the advancement of the interest free loan by the assessee/appellant to its sister concern, is in due course of business, is legally sustainable ?

(x) Whether the action of the assessing officer in excluding its jurisdiction by acting merely on its presumption and right in the eyes of law ?

(xi) Whether in the facts and circumstances of the case, Annexures A.1 to A.3 are legally sustainable?"

During the course of assessment, it was found that the assessee had advanced interest free loans to M/s Brijmohan Lal & Associates, M/s S.K. Rai and Sons (HUF), L.Bahadur Chand Munjal Charitable Trust, M/s Brijmohan Lal and Associates and M/s S.K. Rai and Sons (HUF) for non-business purposes. Some amounts were advanced during the earlier years, whereas some amounts were advanced during the current year. The assessee was also found to be incurring the liability to pay interest on the loans raised or otherwise. The assessee was asked to

explain as to why, out of the interest paid by the assessee, interest to the extent advances have been made to sister concerns/ associates on interest free basis, be not disallowed. The only response made by the assessee to this was that no interest may be disallowed and the issue may be decided in accordance with law. The Assessing Officer keeping in view the earlier orders passed, which were upheld by the Commissioner of Income-tax (Appeals), [for short, `the CIT (A)'] disallowed the interest to the extent of Rs. 4,06,055/-. In appeal, the assessee failed before the CIT (A) as far as the principal issue is concerned. However, for calculation of interest, the matter was remitted back to the Assessing Officer. In further appeal before the Tribunal, the assessee failed.

We have already considered an identical issue in Commissioner of Income-Tax v. Abhishek Industries Ltd., (2006) 286 ITR 1, wherein this Court held as under:

> "As far as the issue of establishment of nexus of the funds borrowed vis-a-vis the funds diverted towards sister concern on interest free basis is concerned, in our view, the stand of the assessee that the onus of proving the nexus of funds available with the assessee with the funds advanced to the sister concerns without interest is on the Revenue is not correct. Section 36(1)(iii) of the Act provides for deductions of interest on the loans raised for business purposes. Once the assessee claims any such deduction in the books of accounts, the onus will be on the assessee to satisfy the Assessing Officer that whatever loans were raised by the assessee, the same were used for business purposes. If in the process of examination of genuineness of such a deduction, it transpires that the assessee had advanced certain funds to sister concerns or any other person without any interest, there would be very heavy onus on the assessee to be discharged before the Assessing Officer to the effect that inspite of pending term loans and working capital loans on which the assessee is incurring liability to pay interest, still there was justification to advance loans to sister concerns for non-business purposes without any interest and accordingly, the assessee should be allowed deduction of interest being paid on the loans raised by it to that extent. In our view, even

the plea of nexus of loans raised by the assessee with the funds advanced to the sister concerns on interest free basis, may be it is pleaded to be out of sale proceeds or share capital or different account cannot be accepted.

Entire money in a business entity comes in a common kitty. The monies received as share capital, as term loan, as working capital loan, as sale proceeds etc. do not have any different colour. Whatever are the receipts in the business, that have the colour of business receipts and have no separate identification. Sources has no concern whatsoever. The only thing sufficient to disallow the interest paid on the borrowing to the extent the amount is lent to sister concern without carrying any interest for non-business purposes would be that the assessee has some loans or other interest bearing debts to be repaid. In case the assessee had some surplus amount which, according to it, could not be repaid prematurely to any financial institution, still the same is either required to be circulated and utilised for the purpose of business or to be invested in a manner in which it generates income and not that it is diverted towards sister concern free of interest. This would result in not presenting true and correct picture of the accounts of the assessee as at the cost being incurred by the assessee, the sister concern would be enjoying the benefits thereof. It cannot possibly be held that the funds to the extent diverted to sister concerns or other persons free of interest were required by the assessee for the purpose of its business and loans to that extent were required to be raised. We do not subscribe to the theory of direct nexus of the funds between borrowings of the funds and diversion thereof for non-business purposes. Rather, there should be nexus of use of borrowed funds for the purpose of business to claim deduction under Section 36(1)(iii) of the Act. That being the position, there is no escape from the finding that interest being paid by the assessee to the extent the amounts are diverted to sister concern on interest free basis are to be disallowed.

If the plea of the assessee is accepted that the interest free advances made to the sister concerns for non-business purposes was out of its own funds in the form of capital introduced in business, that again will show a camouflage by the assessee as at the time of raising of loan, the assessee will show the figures of capital introduced by it as a margin for loans being raised and after the loans are raised, when

substantial amount is diverted to sister concerns for non-business purposes without interest, a plea is sought to be raised that the amount advanced was out of its capital, which in fact stood exhausted in setting up of the unit. Such a plea may be acceptable at a stage when no loans had been raised by the assessee at the time of disbursement of funds. This would depend on facts of each case.

Section 106 of the Indian Evidence Act or the principles analogous thereto places the burden in respect thereof upon the assessee, as the facts are within its special knowledge. However, a presumption may be raised in a given case as to why an assessee who for the purpose of running its business is required to borrow money from banks and other financial institutions would be giving loan to its subsidiary companies and that too when it pays a heavy interest to its lenders, it would claim no or little interest from its subsidiaries."

The order of the Tribunal being in consonance with the law laid down by this Court, we do not find any substantial question of law arises in the present appeal. As the effect of the disallowance of interest in the hand of the assessee on the income of the partners to whom interest was paid having not been considered, we deem it appropriate to remit the matter back to the Tribunal for the limited issue.

As far as the issue regarding partial disallowance of telephone expenses is concerned, the issue has been decided on an admission made by the parties before the Tribunal for the year 1994-95, wherein the disallowance was restricted to 1/7th of the telephone expenses installed at the residence of the partners. That being the position, no interference is called for in the impugned order passed on agreement by parties.

The present appeal is disposed of in the manner indicated above.

(Rajesh Bindal)
Judge

(Adarsh Kumar Goel)
Judge

October 16, 2006
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